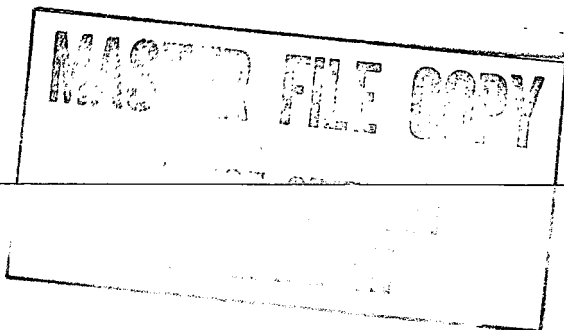




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USSR: Implications of the Hard Currency Problem for Aid to Allies and Clients

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An Intelligence Memorandum

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USSR: Implications of the Hard Currency Problem for Aid to Allies and Clients

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An Intelligence Memorandum

This paper has been prepared by [] Office
of Soviet Analysis. Comments and queries are
welcome and may be addressed to the Chief, Policy
Analysis Division, SOVA, []

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*SOV 82-10173X
November 1982*

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USSR: Implications of the
Hard Currency Problem for
Aid to Allies and Clients

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Summary

*Information available
as of 1 October 1982
was used in this report.*

Faced with hard currency constraints and potential Western credit restrictions, Moscow is trying to conserve foreign exchange, in part by reducing support to dependent allies and clients. In Eastern Europe, the Soviets have reduced subsidized oil exports and adopted a tougher loan policy. In the Third World, Moscow's hard currency assistance to Communist clients has become more restrained. Soviet aid to non-Communist LDCs, which does not involve hard currency expenditures, apparently has not been affected, although Moscow will be even less willing than before to undertake major assistance efforts similar to those carried out in the past for Cuba and Vietnam.

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Although this policy has helped to reduce the Soviets' hard currency trade deficit, it almost certainly will increase problems in Moscow's bilateral relations with East European and Third World countries. Many of them have been seeking expanded Soviet assistance because of their own economic problems and will be unhappy with Moscow's tougher stance. Reduced aid will aggravate Eastern Europe's economic difficulties and could thus encourage increased consumer unrest and anti-Soviet feeling. As a result, Moscow's efforts to achieve both closer economic integration within the region and increased East European financing of Warsaw Pact modernization could be undercut.

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Soviet problems with Third World countries over economic aid probably will be mitigated in some cases by Moscow's ability and willingness to provide rapid and large-scale military assistance, but the potential for increased difficulties over economic support will remain. Arms agreements with LDCs have risen substantially in recent years, with their value far exceeding that of economic assistance commitments. In coming years, the USSR will continue to view arms sales as a major source of both influence and foreign exchange and will probably focus its arms export efforts on the Middle East, South Asia, and North Africa. As Third World needs for economic aid rise, however, Soviet weapon sales for hard currency may increasingly seem to some LDC governments an inadequate and even economically burdensome form of support. Particularly in the case of countries experiencing severe balance-of-payments problems, Moscow may encounter increasing difficulty in sustaining or expanding its arms exports.

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Introduction

The hard currency squeeze that emerged in 1981 has prompted the USSR to find ways to reduce the outflow of foreign exchange. Presumably unwilling to increase their hard currency debt to the West substantially, the Soviets have scaled back imports of some Western products and reduced their economic support of some allies and clients. Hard currency expenditures large and small, direct and indirect, reportedly have been affected. These adjustments have helped to reduce the Soviets' hard currency trade deficit, but the improvement is probably temporary, since foreign exchange constraints are likely to persist through the 1980s.

This memorandum discusses the general reasons for the cutbacks, then focuses on reported reductions in support to East European and Third World countries. It suggests how Soviet policies—including the arms sales program—and bilateral ties in those regions could be affected.

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Growing Hard Currency Problems

The Soviet economy's slowdown is raising the importance of imports in helping to maintain productivity. The rate of growth is falling, from nearly 4 percent per year in the 1970s to an average of 1.5 percent per year in 1980 and 1981. Recent Soviet data indicate that the growth rate in 1982 will be at least as low. The chief causes are rising resource costs, an inefficient economic system, production shortfalls in agriculture and industry, and an accumulation of planning mistakes. Moreover, growth in labor productivity has slowed just as demographic trends are beginning to curtail the supply of new labor. Imports can relieve some economic problems by raising the technological level of major Soviet industries and by reducing shortages of grain and important industrial materials, as they did in the 1970s when purchases of chemicals, steel, machinery, and agricultural products rose substantially (table 1). In the 1980s, Western equipment and know-how will be particularly important to raising productivity in the critical machine-building and energy industries.

However, Soviet hard currency revenues needed for purchasing Western goods probably will remain level or even decline in real terms during the next several years. Foreign exchange earnings have risen substantially since the early 1970s, led by oil exports and, more recently, supported by gas and arms sales (tables 2 and 3). Nonetheless, the USSR's hard currency position worsened in early 1981, primarily because of weaker demand for its oil exports and sharply increased grain imports after a

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Table 1
USSR: Hard Currency Imports ^a

Million US \$

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981 ^b
Total ^c	2,984	3,093	4,342	6,744	8,695	14,577	15,478	14,805	17,026	21,435	26,070	27,778
Grain	101	185	770	1,423	635	2,323	2,627	1,356	2,353	3,279	4,360	6,217
Other agricultural products	657	600	543	1,118	1,388	1,760	1,665	2,005	1,721	2,854	4,400	5,104
Machinery and equipment ^d	967	960	1,283	1,739	2,334	4,593	5,074	5,117	5,970	6,032	6,039	4,523
Ferrous metals ^d	303	374	498	899	1,942	2,627	2,296	1,819	2,588	3,536	3,606	3,597
Chemicals	215	206	249	270	707	722	609	658	815	1,190	1,545	1,590
Other ^c	741	768	999	1,295	1,689	2,552	3,207	3,850	3,579	4,544	6,120	6,747

^a Includes imports from all countries trading with the Soviet Union on a hard currency basis as of 1 January 1980.

^b Estimated.

^c Includes the following imports, which the USSR reported in footnotes, and which we believe are associated with the Orenburg natural gas pipeline: \$420 million in 1976, \$888 million in 1977, \$286 million in 1978, \$30 million in 1979, and \$18 million in 1980.

^d Excluding imports associated with the Orenburg pipeline.

Source: Official Soviet foreign trade statistics.

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string of poor harvests. Although the situation has improved since mid-1981, partly because of reduced nonagricultural imports and increased oil and gold sales, the Soviets' prospects for maintaining that improvement over the long run are bleak.¹ Our analysis indicates that:

- Oil exports, the leading hard currency earner, will become increasingly hard to sustain in coming years.
- Rising gas exports probably will not offset fully the drop in oil revenues, even after the pipeline to Western Europe is completed.
- Real earnings from other exports are unlikely to grow appreciably.
- Sales of gold and arms, which have helped to minimize previous trade deficits, probably cannot prevent larger deficits from emerging.

We expect the Soviets' hard currency position to fluctuate in the next few years, as it has since the mid-1970s. By 1990, however, we estimate that the constraints on hard currency revenues and a rising need in real terms

¹ We estimate that the Soviets reduced their hard currency trade deficit from \$6 billion in January-June 1981 to \$2.2 billion in the first half of 1982.

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Table 2
USSR: Hard Currency Exports ^a

Million US \$

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981
Total	2,424	2,776	2,954	5,009	7,869	8,280	10,225	11,863	13,336	19,417	23,584	23,778
Petroleum ^b	430	608	600	1,304	2,741	3,391	4,748	5,583	5,710	9,585	12,293	12,232
Natural gas	14	21	24	32	95	220	358	566	1,072	1,404	2,704	3,968
Coal and coke	106	127	124	139	256	402	377	366	295	315	366	179
Machinery and equipment	193	207	267	360	398	647	803	905	1,299	1,574	1,466	1,534
Ferrous metals	137	131	130	216	236	164	171	181	129	216	246	169
Wood and wood products	389	379	421	747	1,046	739	889	1,084	991	1,370	1,500	1,016
Chemicals	64	65	70	110	246	243	198	215	287	542	746	770
Agricultural products	192	340	360	367	677	547	553	652	447	457	454	690
Diamonds	175	257	371	515	545	478	511	606	773	1,043	1,304	3,220
Other	724	642	587	1,219	1,629	1,449	1,617	1,705	2,333	2,911	2,505	

^a Includes exports to all countries trading with the Soviet Union on a hard currency basis as of 1 January 1980.

^b These data were calculated by adding estimates of oil exports to those LDCs for which there are no Soviet data to the total calculated from Soviet statistics.

Source: Official Soviet foreign trade statistics and—for diamond exports—OECD statistics.

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for Western goods and technology will have caused the gap between foreign exchange requirements and earnings to exceed the roughly \$6 billion level of 1981. [REDACTED]

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Moscow probably does not see increased reliance on Western credits as a solution to the hard currency problem. Both Western bankers and the financially conservative Soviet leaders presumably would be reluctant to increase substantially the existing Soviet debt burden (table 4). [REDACTED]

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[REDACTED] Although the vague language of the agreement on credits achieved at the Versailles summit in June and the subsequent disunity in Western ranks over US trade sanctions probably have eased Soviet apprehensions, Moscow probably still recognizes that credits will be more costly to obtain than in the 1970s. [REDACTED]

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Table 3
USSR: Estimated Hard Currency Balance of Payments

Million US \$

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981 ^a
Current account balance	-103	40	-1,121	-822	238	-4,907	-3,566	-1,258	-1,843	3,823	1,004	700
Trade balance	-560	-317	-1,388	-1,735	-826	-6,297	-5,253	-2,942	-3,690	-2,018	-2,486	-4,000
Exports, f.o.b.	2,424	2,776	2,954	5,009	7,869	8,280	10,225	11,863	13,336	19,417	23,584	23,778
Imports, f.o.b.	2,984	3,093	4,342	6,744	8,695	14,577	15,478	14,805	17,026	21,435	26,070	27,778
Net interest	-83	-48	-60	-80	-103	-570	-724	-848	-881	-799	-710	-1,300
Arms receipts	35	50	NEGL	250	250	1,200	1,500	1,500	1,700	5,500	3,300	5,000
Other invisibles and transfers	505	355	327	743	917	760	911	1,032	1,028	1,140	900	1,000
Capital account balance	NA	NA	-29	611	488	5,797	2,518	1,212	-788	-1,152	305	2,965
Gross drawings ^b	NA	NA	906	1,737	2,052	6,371	5,495	2,857	3,096	4,474	3,103	5,995
Government backed	450	511	425	495	1,164	1,972	2,450	1,991	2,565	2,410	2,433	2,300
Commercial	NA		481	1,242	888	4,399	3,045	866	531	2,064	670	3,695
Repayments	NA	NA	306	397	625	969	1,366	1,955	2,332	2,800	3,034	3,170
Government backed	159	223	276	338	483	730	1,036	1,285	1,456	1,702	1,915	1,945
Commercial	NA		30	59	142	239	330	670	876	1,098	1,119	1,225
Net change in assets ^c	NA	NA	-629	-729	-939	395	-1,611	310	-1,552	-2,826	236	140
Gold sales	NEGL	24	289	962	1,178	725	1,369	1,618	2,522	1,490	1,580	2,700
Net errors and omissions ^d	NA	NA	861	-751	-1,904	-1,615	-321	-1,572	109	-4,161	-2,889	-6,365

^a Provisional estimate.^b Including additions to short-term debt.^c Net change in Soviet assets held with Western commercial banks (a negative sign signifies an addition to assets).^d Includes hard currency assistance to other Communist countries; hard currency trade with other Communist countries; hard currency credits to LDCs to finance Soviet sales of machinery and equipment including military equipment; and credits to developed Western countries to finance sales of oil and other commodities.

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Table 4
USSR: Hard Currency Debt to the West

Million US \$

	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981
Commercial debt	407	858	2,041	2,787	6,947	9,662	9,858	9,513	10,477	10,030	12,500
Medium and long term	NA	NA	NA	NA	NA	NA	NA	6,409	7,184	6,118	6,750
Short term	NA	NA	NA	NA	NA	NA	NA	3,104	3,293	3,912	5,750
Government-backed debt	1,401	1,550	1,708	2,388	3,631	5,045	5,751	6,860	7,568	8,086	8,411
Gross debt	1,808	2,408	3,749	5,175	10,578	14,707	15,609	16,373	18,045	18,116	20,911
Assets with Western banks	1,225	1,854	2,583	3,522	3,127	4,738	4,428	5,980	8,806	8,572	8,432
Net debt	583	554	1,166	1,653	7,451	9,969	11,181	10,393	9,239	9,544	12,479
Debt service	409	476	729	1,133	1,773	2,378	3,095	3,551	4,230	4,652	5,371
Debt service ratio (percent)		13	10	10	17	18	19	18	17	15	17

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Cutting Corners Around the Globe

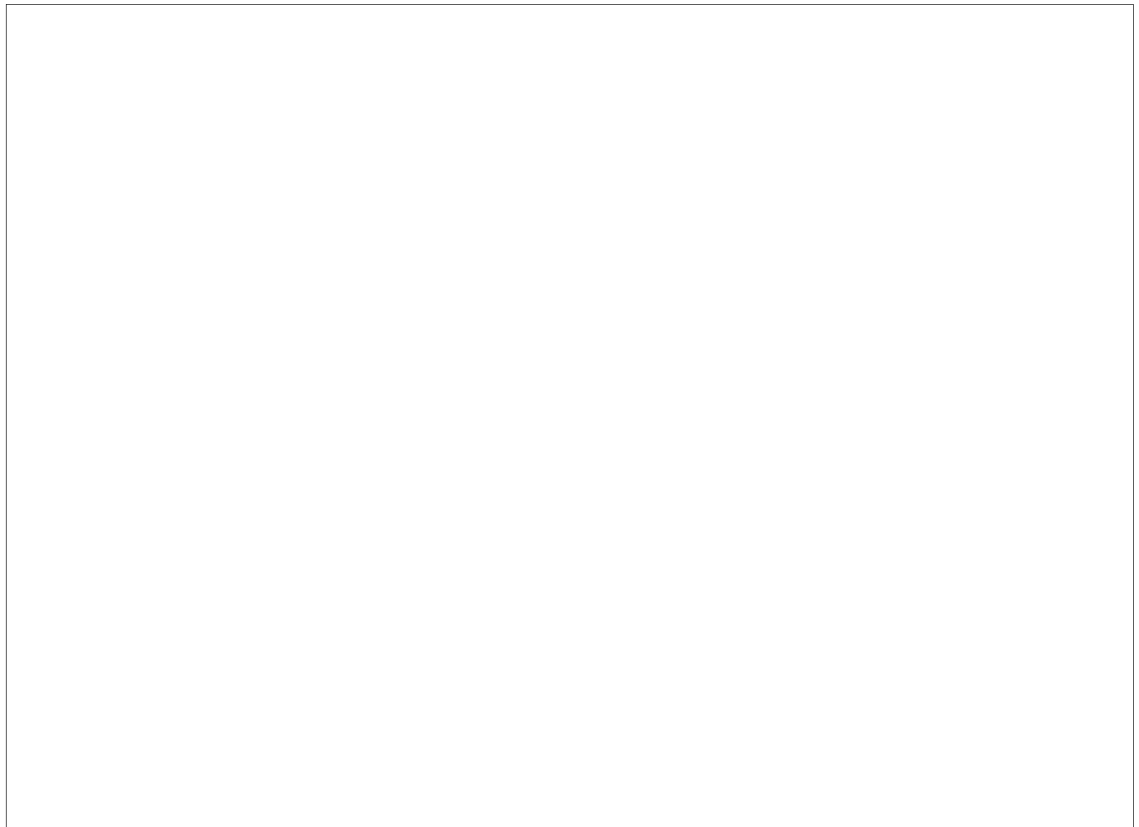
With tighter hard currency supplies in mind, the Soviets are reducing their expenditures of foreign exchange across the board. Although we cannot yet estimate precisely the overall size or duration of the cutbacks, we believe that trade with the West, economic support of Eastern Europe, and assistance to some less developed countries (LDCs) are being affected. Reductions in imports of Western goods and in exports of oil to allies at below-market prices could bring potential savings of a few billion dollars.

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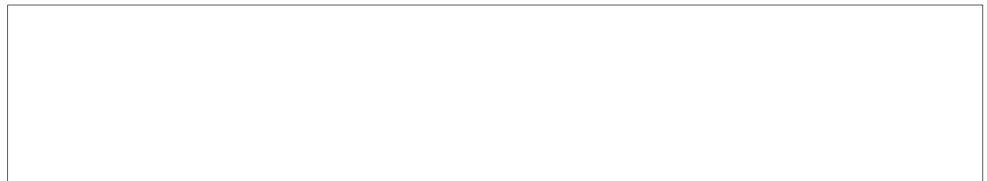
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**Third World
Communist Clients**

Moscow's belt tightening apparently has affected its economic support of Communist countries and parties in the Third World. Some indications in recent months of Moscow's tougher stance are that:

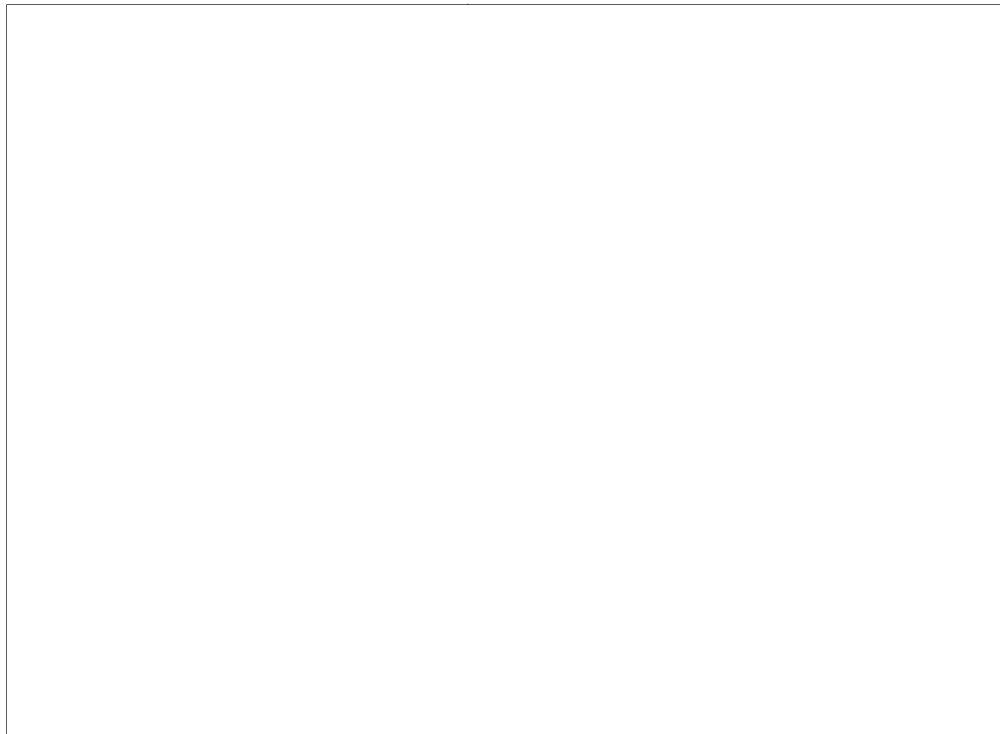
- Although Moscow increased commodity shipments to Vietnam in 1981, recent public Soviet statements suggest that Vietnam's requests for further increases in subsidized shipments of oil and food have been turned down.
- Reductions in Soviet oil shipments to Cuba in 1982 were considered, according to Cuban officials. Although the Soviets agreed instead to provide financial incentives for Cuba to cut oil consumption, the option of reduced deliveries in subsequent years has presumably been left open.



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*Developing Countries*

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Moscow rarely provides hard currency support to non-Communist LDCs, but instead emphasizes project assistance often repaid with the resulting LDC products. While the amount of Soviet aid allocated to such countries has grown in the past decade [redacted] repayment terms have hardened, with 10-year repayment periods having become more common than 12-year credits over the past five years. Our observations of the Soviets' assistance effort during the past decade indicate that their primary economic goal in extending development aid has been to sell Soviet equipment, although more recently they have given increased attention to procuring products important to their economy through commodity pay-back and barter contracts that minimize their overall hard currency expenditures. [redacted]

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The Soviets' current concern over foreign exchange availability has not affected their aid program for non-Communist LDCs but certainly has contributed to their continuing stinginess with those countries where hard currency is involved. Some recent indications that Moscow has not changed its longstanding policy regarding hard currency support are that:

- Nicaragua, despite the economic cooperation pledged during junta coordinator Daniel Ortega's visit to Moscow in May, has still not obtained the substantial level of Soviet hard currency aid it has been seeking since 1980, according to Embassy and press reporting.

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- Guyana has publicly criticized Soviet industrial cooperation programs, in part because Moscow has demanded that Georgetown pay more of the hard currency expenses associated with planned projects. 

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Some Political Implications

The Soviets are certainly aware that these actions carry a political price, but they apparently expect that it will be bearable. In Eastern Europe, Moscow is probably assuming that there is enough fat in the economies and sufficient political stability to enable them to adapt. The Soviets have been telling their CEMA partners for years that their energy use can be substantially reduced. Moscow also has made its cuts with some political selectivity by excluding Poland, the least stable of the East European regimes. As for the Third World, Soviet qualms may be lessened by the fact that economic assistance generally has been limited and has rarely brought substantial and continuing political benefits. The Communist regimes receiving aid, moreover, may be seen by Moscow as having few options for acquiring substantial non-Soviet assistance in the short run. Nonetheless, the Soviets cannot be certain that problems created by aid reductions will not ultimately harm their relations with their allies and some important Third World countries. [REDACTED]

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Moscow's budget cutting will almost certainly increase hardships for Eastern Europe. Reductions in material and financial support, though still relatively modest, are contributing to the region's already bleak economic outlook, raising the prospect of increased consumer dissatisfaction. The East Europeans have little prospect for buying oil on the world market or for purchasing additional Soviet oil for hard currency. Their energy conservation efforts have generally been ineffective thus far, and investment cutbacks are hindering energy savings by slowing the introduction of more energy-efficient plant and equipment. Although we cannot determine precisely the impact of reduced oil supplies, we believe that all three of the East European economies currently targeted for cutbacks will suffer:

- In Czechoslovakia, GNP will stagnate at best, and with reduced oil deliveries a decline in living standards is likely. Substantial reductions in heating oil and motor fuel supplies are already part of an austere 1982 plan.
- In East Germany, the reduction in Soviet oil supplies will hamper growth through 1985. Recent conservation measures such as a 12.5-percent decrease in diesel fuel allocations will slow the growth of industrial output.
- In Hungary, continued stagnation is likely under reduced Soviet deliveries. Budapest has already imposed three straight years of economic austerity in an effort to balance its foreign trade accounts. [REDACTED]

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Although we do not expect Soviet aid reductions to threaten the type of major economic problems plaguing Poland, they may lead to increased political problems for some East European regimes. If tighter oil supplies cause more severe shortages of fuel and consumer goods, consumer

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dissatisfaction almost certainly will hamper efforts to increase worker productivity and may cause more serious popular unrest and anti-Soviet feeling. []

Moreover, political disagreement within the Eastern alliance could increase as a result of the cuts. Any setback to the East European economies, for example, could sharpen Soviet and East European disagreement over the financing of the Bloc's defense effort. The economic burden of effecting Warsaw Pact force improvements and sustaining current levels of training activity would rise, as the Hungarian defense minister suggested in an interview published in July. In that case, East European foot-dragging on military modernization, which has displeased the Soviets for several years, would probably increase. Reduced aid also will complicate the USSR's efforts to increase regional economic integration, which have probably intensified following US economic sanctions.³ The economic and possible political difficulty that the aid reduction will cause the East Europeans, and their probable concern that more cutbacks may follow, will probably provide an incentive for them to seek other sources of economic support. Hungary's recent admission to the IMF suggests that the Soviets may have minimized their objections to the move in view of their own reduced assistance. []

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Soviet influence with some Third World clients may suffer as an already niggardly economic aid program fails to meet those countries' growing needs. Moscow has long incurred criticism in the Third World for its meager economic assistance, and it may now encounter growing trouble with economically hard-pressed countries that have been seeking increased Soviet help. Aid has been a sore point in Soviet-Vietnamese relations. Relations with Cuba, where aid-related tensions do not yet appear serious, could be affected if the Cuban economy's rate of growth declines substantially, as projected. Among non-Communist countries, Ethiopia is unhappy with its inability to augment Soviet military assistance with extensive cooperation in economic development, [] and South Yemen reportedly holds a similar view. Angola, whose oil exports give it more ability than most major Soviet clients to pay in hard currency for aid projects, is the only Third World country to obtain a major new Soviet credit commitment []

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³ Several Soviet party and government officials have stated publicly in recent months that the US sanctions have taught CEMA that it should rely more heavily on trade among its own members. []

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Table 8
USSR: Military Aid Agreements
With LDCs

Million US \$

Total	68,415
1954-76	28,225
1977	9,335
1978	2,520
1979	8,360
1980	13,915
1981	6,060

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Soviet problems with Third World countries over economic aid probably will be mitigated in some cases by Moscow's ability and willingness to provide rapid and large-scale military assistance, but the potential for growing difficulties over economic support will remain. Arms agreements with LDCs have risen substantially in recent years (table 8), with their value far exceeding that of economic assistance commitments.⁴ In coming years, we believe that the USSR will continue to view arms sales as a major source of both influence and foreign exchange and will probably focus its arms export efforts on the Middle East, South Asia, and North Africa.⁵ As Third World needs for economic aid rise, however, Soviet weapon sales for hard currency may increasingly seem to some LDC governments an inadequate and even economically burdensome form of support. Particularly in the case of countries experiencing severe balance-of-payments problems, Moscow may encounter increasing difficulty in sustaining or expanding its arms exports. [REDACTED]

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⁴ Orders for weapons dropped to \$6 billion in 1981, down from the 1980 record high of \$14 billion, but still were not significantly lower than the average sales level established since the mid-1970s. [REDACTED]

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⁵ Moscow may scrutinize more carefully its concessionary military assistance, but military aid to major clients such as Cuba, India, and Vietnam probably will remain based primarily on political rather than economic considerations. [REDACTED]

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